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No. 94-1868

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

NORTH CAROLINA POWER,
Petitioner,
v.
STATE OF NORTH CAROLINA *ex rel.*
UTILITIES COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of North Carolina

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PETITIONER'S REPLY MEMORANDUM

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North Carolina, through its Attorney General and the Public Staff of the North Carolina Utilities Commission, advance three primary points in opposition to North Carolina Power's petition.

First, the Attorney General maintains that the North Carolina Utilities Commission simply was exercising the same delegated authority under PURPA in 1993 in establishing retail rates that the Virgina State Corporation Commission exercised in 1987 and 1988 when Virginia ordered Virginia Power to make a wholesale purchase of the Ultra Cogen power at $341 per kW.

Second, the Public Staff maintains that when Virginia ruled upon the Ultra Cogen petition, filed pursuant to FERC's rules, implementing PURPA, and resolved the dispute between the QF and the electric utility through interpretation of FERC's regulations, Virginia was estab-

lishing a price above $171 per kW based on Virginia law, not Federal law.

Third, the Public Staff argues that there are no trapped costs as proscribed by *Nantahala Power & Light Co. v. Thornburg* [1] and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore* [2] when North Carolina prohibited North Carolina Power from recovering $1.39 million per year in wholesale costs. The Public Staff argues that the utility theoretically can recover these costs in a Virginia retail rate proceeding.

These three points are factually and legally insupportable and demonstrate why the petition for certiorari raises important Federal issues and should be granted.

A.

First, contrary to the Attorney General's assertion, North Carolina was not implementing PURPA when it prohibited North Carolina Power (the name under which Virginia Power operates in North Carolina) from recovering $1.39 million per year of wholesale costs in retail rates. As all parties acknowledge, North Carolina's decision did nothing to establish the wholesale price Virginia Power must pay Ultra Cogen and therefore was not a decision establishing a wholesale rate. As the NCUC stated: "[i]n making this decision, we recognize our obligation to encourage QFs, but that is not the issue here. The issue here is ascertaining reasonable operating expenses for purposes of setting just and reasonable [retail] rates in North Carolina." App. 74a. The Ultra Cogen wholesale costs are the operating expenses the NCUC examined in establishing the retail rates for North Carolina consumers. In contrast, Virginia's 1987 and 1988 decisions established the price of the wholesale power. Virginia was implementing PURPA; North Carolina was not.

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[1] 476 U.S. 953 (1986).

[2] 487 U.S. 354 (1988).

B.

Secondly, the Public Staff suggests that to the extent a portion of the $341 per kW price of the wholesale power exceeded $171, the determination approving the excess was based on State law. Contrary to the Public Staff's position, the price Virginia required Virginia Power to pay the QF above $171 per kW was not based on Virginia authority. Under the Supremacy Clause and the Commerce Clause decisions of this Court, Virginia has no state authority to establish a wholesale rate. The rate was established wholly through a delegation of Federal authority. The difference between the $341 per kW Virginia required in 1988 and the ceiling of $171 per kW selected by North Carolina five years later arose because Virginia interpreted the pertinent FERC regulation, 18 C.F.R. § 292.304(d)(2) (1987), to require that Virginia Power's avoided costs be determined at November 12, 1987. Virginia determined that there were no competitive bids in existence on that date that could be used to determine avoided costs. Virginia determined that avoided costs could only be determined with reference to Virginia Power's Chesterfield 7 plant costs as projected on that date, not bids submitted by competing suppliers calculated through reference to Chesterfield 7 costs as a benchmark. Use of Chesterfield 7 costs to establish avoided costs under PURPA is through reference to projected costs at the time the QF's obligation to sell is fixed. The projected future costs will vary on the basis of both the method for determining the costs and the date on which the costs are projected.

North Carolina's utilities commission found only that Virginia's attempt to implement PURPA produced a cost that was unreasonable for retail ratemaking or resulted from an interpretation that was not mandated by PURPA. However, as the North Carolina Attorney General emphasizes, PURPA gives the States wide latitude in implementing the provisions of PURPA requiring them to resolve disputes over price between QFs and utilities, as

did Virginia here. Attorney General's Brief in Opposition, pp. 11-13.

Whether Virginia's implementing decisions are the same as North Carolina would have made, however, is immaterial for purposes of the issue raised in this petition. The question is whether the authority Virginia exercised in selecting a wholesale price was Federal authority under PURPA, thereby preempting North Carolina's actions, or was State authority under State police power. As Virginia was exercising Federal authority, North Carolina was precluded from making a collateral attack on the Federal decision in a retail proceeding.

PURPA cannot be read to impose a cap of $171 per kW for the Ultra Cogen power so that a price of $172 or higher ceases to be grounded on PURPA but instead may only be authorized on state authority.[3] Tellingly, the Public Staff argues that an appropriate price under PURPA was both $141 per kW and $171 per kW. However, the Public Staff's argument that any price in excess of $171 ceases to be authorized under PURPA is inconsistent with its argument that a *range* from $141 to $171 is permissible under PURPA.

In reality it is North Carolina's attempt to support the $171 per kW through reference to PURPA that must fail. North Carolina ignored FERC's mandatory regulations in selecting the $171 price. Rather than follow FERC's regulations, which Virginia interpreted to require avoided costs to be determined on November 12, 1987, North Carolina looked to "contemporaneous" points of measurement. According to the Attorney General, "contemporaneous" as used by North Carolina means an "average purchase rate for capacity from contracts entered as a result of competitive bids initiated *less than*

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[3] It must be remembered that the $171 per kW is an average of prices, many of which are above $171. If $171 is the cap, approximately one half of the prices making up the average exceed the cap, none of which were deemed by North Carolina to be in excess of federally mandated avoided costs.

a year earlier in December 1986, and just *a few months later* in March 1988, as well as rates set by the North Carolina Commission for small projects at the time the Ultra Cogen petitions were filed." Attorney General's Brief in Opposition, p. 20 (emphasis added). These "contemporaneous" measurements are at odds with PURPA regulations that address the date on which the wholesale determination of avoided costs is to be made. As the Virginia arbitrator ruled, the results of the 1988 solicitation, used by the NCUC to set the retail rate, were not known when the Ultra Cogen price had to be set.

The Public Staff incorrectly argues that the NCUC compared the Ultra Cogen contracts with contemporaneous measures of avoided costs and concluded that the prices in the Ultra Cogen contracts exceeded Petitioner's avoided costs "at the time the arbitration petitions were filed." Public Staff's Brief in Opposition, p. 7. The Public Staff's reference to the appendix (p. 73a) does not support the argument that the NCUC sought to set a price at November 12, 1987. The North Carolina Attorney General more accurately recites the NCUC's actions:

> The North Carolina Commission compared the purchase price for Ultra Cogen capacity with other contemporaneous measures of avoided costs for Virginia Power, and found the Ultra Cogen price out of line.

Attorney General's Brief in Opposition, p. 7. As this description indicates, the NCUC was drawing comparisons without reference to FERC regulations.[4]

C.

Thirdly, the Public Staff argues for the first time that the North Carolina decision does not trap wholesale costs

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[4] The Attorney General's accurate description of the NCUC's actions precluded the argument that is essential to the Public Staff's brief and the North Carolina Supreme Court's opinion that the $341 per kW Ultra Cogen price does not carry preemptive force because it is based on Virginia instead of Federal authority.

by preventing their recovery through retail rates because the wholesale costs North Carolina disallows can be recovered in a Virginia retail rate proceeding. This argument is premised on the assumption, refuted above, that the $1.39 million in wholesale expenses was authorized on the basis of Virginia state law. Moreover, in a Virginia retail rate proceeding, Virginia retail ratepayers plainly cannot be required to pay both for the Ultra Cogen power Virginia Power actually sells to these consumers and part of the Ultra Cogen power Virginia Power sells to North Carolina consumers. Even if the responsibility for paying for what North Carolina disallows could be shifted to Virginia consumers, North Carolina cannot force this result by unilaterally prohibiting the recovery of the wholesale costs in a retail rate case in North Carolina.

The remedy the Public Staff advocates is the very remedy this Court reversed in *Nantahala* and *Mississippi Power*. In *Nantahala* the intent of the ratemaking device North Carolina had employed was to shift responsibility for wholesale costs from the North Carolina retail ratepayers to the Tennessee consumer.[5] North Carolina has no jurisdiction to reallocate the cost of the Ultra Cogen wholesale power it disallows in retail ratemaking to Virginia. Only FERC could have the authority to impose the remedy North Carolina advocates. The only authority North Carolina cites as a basis for this remedy, *Orange & Rockland*, has been vacated by FERC. *Orange & Rockland Utilities, Inc.*, 70 FERC ¶ 61,014 (1995). Consequently, there is no authority for the position whatsoever.

Even if *Orange & Rockland* had not been vacated, the reallocation hypothetically addressed in that FERC order is not available in this case. Orange & Rockland, the entity that purchased power from a QF at prices in excess of avoided costs on the basis of New York law, supplies wholesale power to affiliated systems in other states pur-

[5] 476 U.S. at 959-961.

suant to wholesale power supply agreements under FERC's jurisdiction.[6] FERC suggested that, through exercise of its jurisdiction over these agreements, it could prevent the allocation of excess costs from Orange & Rockland, which operates in New York, to the other affiliates, which operate outside of New York. No such comparable inter-affiliate wholesale agreements exist in this case. Virginia Power is a single electric utility operating in two states. There are no wholesale transactions or agreements between Virginia Power's operating territory in Virginia and North Carolina, and therefore there are no agreements under which FERC could allocate wholesale costs.

Further, even if reallocation of the wholesale costs were an appropriate remedy, North Carolina's decision is still preempted because North Carolina failed to impose any such remedy. Instead, North Carolina unlawfully resorted to self help. North Carolina could have gone to the proper Federal authority to argue that the price of the wholesale power resold in North Carolina be reduced. Alternatively, North Carolina could have gone to FERC to request a reallocation of the power to another jurisdiction that could not deny recovery of the costs. North Carolina cannot unilaterally through its retail ratemaking prohibit recovery of Federally-approved wholesale costs.

CONCLUSION

The case raises important Federal issues regarding the authority of North Carolina to review a Federal wholesale order and "trap" wholesale electric costs in a retail rate proceeding. Virginia, in the exercise of unquestioned Federal jurisdiction, ordered Virginia Power to sign a contract with Ultra Cogen. A portion of the Ultra Cogen wholesale power is resold at retail in North Carolina. Virginia followed FERC regulations in resolving the dispute between Virginia Power and Ultra Cogen in estab-

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[6] *Orange & Rockland Utilities, Inc.*, 43 FERC ¶ 61,067 at pp. 61,185-61,186.

lishing the wholesale price. Virginia earlier had expressly repudiated the concept of permitting a price to a QF in excess of avoided costs as defined by PURPA on the basis of State law.

Virginia has not done anything more than exercise its discretion, for which it is given wide latitude, under PURPA. The Virginia decision is a Federal one, not a State one. In contrast, it is impossible to read the NCUC decision and conclude that it is anything other than a State decision establishing retail rates. North Carolina is pre-empted under *Nantahala* and *Mississippi Power* from reviewing a previously determined Federal wholesale rate.

The Court should grant North Carolina Power's petition. The decision of the North Carolina Supreme Court raises substantial Federal issues and conflicts with the decisions of this Court requiring States to honor Federal decisions establishing wholesale electric rates.

Respectfully submitted,

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